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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1979

No. 79-1073

MUTUAL OF OMAHA INSURANCE COMPANY, a corporation,
Appellant,

v.

MICHAEL EGAN,
Appellee.

On Appeal From The Supreme Court Of California

JURISDICTIONAL STATEMENT

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JURISDICTIONAL STATEMENT

PRELIMINARY STATEMENT

Mutual of Omaha Insurance Company, the appellant, appeals from the final judgment of the Supreme Court of California, filed August 14, 1979 (petitions for rehearing denied October 11, 1979), holding that the application of section 3294 of the California Civil Code to authorize punitive damages in this case did not unconstitutionally violate appellant's right to due process of law and right of free speech, as guaranteed by the Fourteenth and First Amendments of the Constitution of the United States.

OPINIONS BELOW

The opinion of the Supreme Court of California, which appears in Appendix A, is reported at 24 Cal. 3d 809, 157 Cal. Rptr. 482, 598 P.2d 452 (1979).

The opinion of the Superior Court of the State of California for the County of Los Angeles, dated January 22, 1975, denying appellant's motion for new trial, is not reported. It is reprinted in Appendix B.

JURISDICTION

The decision of the Supreme Court of California, sustaining the constitutionality of California Civil Code section 3294, was filed on August 14, 1979. Petitions for rehearing were entertained and denied on October 11, 1979, *see* Appendix E, and judgment was entered on that same date, *see* Appendix D. A notice of appeal to this Court was duly filed in the Superior Court of the State of California for the County of Los Angeles on November 13, 1979. *See* Appendix F. This appeal is being docketed in this Court within 90 days from the denial of rehearing below. The jurisdiction of this Court is invoked under 28 U.S.C. section 1257(2).

Appellant recognizes that under traditional finality doctrines this appeal might be considered premature, since the trial court's judgment was "reversed as to the award of punitive damages" on grounds that the five million dollars assessed was "excessive as a matter of law,"[1] and retrial has not yet been had. *See Gospel Army v. Los Angeles,* 331 U.S. 543 (1947). *But see Richfield Oil Corp. v. State Board of Equalization,* 329 U.S. 69 (1946).[2]

However, the California Supreme Court decision in this case appears to present an instance where "the federal issue

[1]*See* opinion below, pp. A-15 - A-16 *infra.*

[2]In *Richfield Oil,* a case that had been tried upon stipulated facts, this Court held that in those circumstances a reversal resulting in a retrial was a final judgment for purposes of federal jurisdiction. Said the Court: "Since . . . the Supreme Court of California has passed on the [legal] issues which control the litigation, we take it that there is nothing more to be decided." 329 U.S. at 73-74.

having been decided, arguably wrongly, and being determinative of the litigation if decided the other way, the finality rule was satisfied." *Cox Broadcasting Corp. v. Cohn,* 420 U.S. 469, 486 n.13 (1975). This is especially so where, as here, the only issues remaining to be tried on remand relate to an award of punitive damages against appellant. *See International Brotherhood of Electrical Workers v. Foust,* 47 U.S.L.W. 4600 (U.S. May 29, 1979).[3]

Thus, appellant pursues its appeal now, although "there are further proceedings—even entire trials—yet to occur in the state courts," because it appears that "the federal issue is conclusive or the outcome of further proceedings preordained" within the rule of *Cox,* 420 U.S. at 479; because retrial of the punitive damages issues is an expensive redundancy if constitutionally foreclosed; and because appellant seeks to avoid the possibility that, by deferring its appeal until after a second adverse judgment in the state trial court, it will forfeit its federal challenge.[4]

[3]In *Foust,* this Court granted *certiorari* to consider a federal challenge to a state award of punitive damages in an "unfair representation" action, despite a pending remand to the trial court for consideration of whether the award was so excessive as to require remittitur or retrial. 47 U.S.L.W. at 4600-01; *cf. Brady v. Maryland,* 373 U.S. 83, 85 n.1 (1963) (subsequent trial on sole issue of punishment could not affect federal issue raised on appeal from a criminal conviction).

[4]The question of possible forfeiture of a federal challenge where appellant first awaited the end of state court litigation was raised, but not resolved, in *Rio Grande W. Ry. v. Stringham,* 230 U.S. 44 (1915). There this Court held a second judgment at trial nonreviewable—but had before it the first judgment as well, and was able to take the case on that basis. A number of commentators have recognized the danger of possible forfeiture in circumstances such as those presented in this case. *See, e.g.,* P. Bator, P. Mishkin, D. Shapiro & H. Wechsler, *Hart & Wechsler's The Federal Courts and the Federal System* 629 (2d ed. 1973); R. Stern & E. Gressman, *Supreme Court Practice* 190-92 (5th ed. 1978); Frank, *Requiem for the Final Judgment Rule,* 45 Tex. L. Rev. 292, 317-18 (1966).

QUESTIONS PRESENTED

Whether section 3294 of the California Civil Code, as interpreted by the California courts, is violative of the Fourteenth Amendment of the Constitution of the United States:

(1) because it permits civil juries to award punitive damages whenever they desire and in whatever amount they desire, with no standards, limits or procedural safeguards to guide or control them;

(2) when it is applied to authorize crippling "damages . . . by way of punishing the defendant" for breach of a duty announced for the first time in this case—conduct which, before the decision below, could not reasonably have been expected to result in ordinary tort damages, much less punishment;

(3) because it poses a threat of arbitrary punishment so heavy as to effectively deter access to courts by those who would otherwise pursue their right to judicial process.

Whether section 3294 of the California Civil Code, as interpreted by the California courts, is violative of the First Amendment of the Constitution of the United States because of its chilling effect on the protected speech interests of an insurer when applied without any standards, limits or procedural safeguards to authorize crippling punitive damages for the assertion, without "actual malice," of the insurer's views with respect to a contract dispute with its insured.

CONSTITUTIONAL PROVISIONS AND STATE STATUTES INVOLVED

Fourteenth Amendment, United States Constitution:

No State shall . . . deprive any person of life, liberty, or property, without due process of law.

First Amendment, United States Constitution:

Congress shall make no law . . . abridging the freedom of speech.

Section 3294, California Civil Code:[5]

In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant.

RAISING THE FEDERAL QUESTION

At trial, appellant unsuccessfully sought to limit the standardless and chilling application of Section 3294 during argument on proposed jury instructions. *See, e.g.,* Cl. Tr. 552.

In briefing and arguing its motion for new trial, appellant raised the claim that application of Section 3294 in this case to assess a "punitive damage award against defendants was in violation of the Due Process Clause . . . of the Constitution of the United States." *See, e.g.,* Cl. Tr. 773-83. In denying appellant's motion, the trial court did not explicitly rule on the constitutional issue. *See* Appendix B.

Appellant again raised its constitutional claims in the Supreme Court of the State of California, where forty-six

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[5]Hereafter referred to in this brief as "Section 3294."

pages were devoted to briefing appellant's contention that "Section 3294 of the Civil Code, on its face and as applied here, is unconstitutionally vague . . . [violates] Due Process . . . [and] deters the free exercise of rights guaranteed by the First Amendment." *See* appellant's Supplemental Brief, filed April 15, 1977, at 1-46. The California Supreme Court considered and rejected appellant's constitutional argument in remanding the case for retrial of the punitive damages issues. *See* opinion below, pp. A-8 - A-9 *infra.*

STATEMENT OF THE CASE

The appellant, Mutual of Omaha, is an insurance company owned by its policyholders; there are no shareholders. The appellee, Michael Egan, a roofer by trade, purchased a disability policy from Mutual in 1963. The policy provided benefits of $200 per month for the duration of continuing total disability resulting from accident or confining sickness. Benefits for non-confining sickness were payable for a period not to exceed three months. Between 1963 and 1970, Egan submitted, and was paid for, several claims under the policy. Two later claims, from which this lawsuit arose, were submitted by Egan: one followed a work-related accident in May 1970; the other claim followed surgery on Egan's back in February 1971.

Factual Summary

While certain events were contested in various respects at trial, the relevant facts underlying Egan's complaint may be fairly summarized as follows:

(1) In May 1970, Egan injured his back at work. That same month Egan submitted a claim under the policy for

this injury, and in October 1970, he submitted a supplemental claim. In September 1970, Mutual paid disability-accident benefits on Egan's initial claim. Subsequently, Mutual paid disability-accident benefits on Egan's supplemental claim through September 29, 1970, the return-to-work date established by Egan's physician. In an interview at Egan's home in November 1970, Egan contended he was still unable to work. Mutual, through a claims agent, McEachen, took the position that the opinion of Egan's physician was dispositive. By saying or implying that Egan's claim for disability beyond September 29, 1970 was unjustified, McEachen apparently embarrassed Egan in the presence of his wife and daughter.

(2) Egan did not return to work. After consulting a new physician, Egan submitted to back surgery in February 1971. The following April, Egan submitted another claim for disability benefits based on his post-surgical condition. The physician's portion of the claim form indicated that Egan could return to work "possibly 3-6 months from date of surgery."

(3) In response to this claim, Mutual conducted an investigation which did not include personal contact with Egan's attending physicians. Instead, Mutual relied on the reports of those physicians, Egan's hospital records and various documents relating to Egan's claim for worker's compensation. All of the physicians' reports stated that Egan's condition was a result of a combination of his accident and his pre-existing disease or pathology. None of the three

physicians had been selected by Mutual.[6] Concluding on this basis that Egan's condition was not "independent of sickness and other causes," Mutual determined that he was entitled only to the maximum benefits allowable for non-confining sickness.[7]

(4) After this determination was made, a second Mutual claims agent, Segal, visited Egan at his home and left with him a check for maximum sickness benefits and explained to him the basis for Mutual's decision. Egan disputed Mutual's position and reiterated his contention that he was disabled on account of accidental injury. At the same interview, Egan testified, Segal offered Egan an additional amount to settle his claim on condition that Egan surrender his policy. Egan refused this offer.

(5) Egan thereafter unsuccessfully sought reconsideration of Mutual's position and, in February 1973, brought suit against Mutual and its agents, Segal and McEachen.

Pertinent California Case Law in 1970-71

In handling Egan's claim, the duty Mutual owed its insured was governed by court-explicated tort doctrine as

[6]Dr. Carpenter, the orthopedic surgeon who had performed Egan's surgery, had stated that "[Egan's medical] history appears consistent with a man with probable discogenic disease with multiple aggravations over the last several years, finally culminating in a specific incident a little over seven months ago." Cl. Tr. 306. Another orthopedic surgeon, Dr. Singelyn, had written that "I would apportion 50% of his current subjective complaint to his industrial injury and 50% to the natural progression of his pre-existing pathology of degenerative wear and tear osteoarthritis of the spine." Cl. Tr. 90. The third orthopedic surgeon, Dr. Roback, had also stated that Egan's condition was "50% due to accident and 50% due to pre-existing." Cl. Tr. 299.

[7]Since Egan was admittedly not confined, the question of whether continuing disability benefits were due turned on whether his condition resulted from "accidental bodily injuries received while the policy is in force and resulting in loss independently of sickness and other causes" as those terms were defined in his policy.

well as by conventional contract law. At the time of Mutual's dealings with Egan, California case law relevant to claims arising from insurance agreements may be fairly summarized as follows:

(1) Since 1958, California courts had held that every insurance contract includes an implied-in-law covenant of good faith and fair dealing. *See, e.g., Comunale v. Traders & General Insurance Co.*, 50 Cal. 2d 654, 658 (1958); *Crisci v. Security Insurance Co.*, 66 Cal. 2d 425, 429 (1967). In effect, such decisions created a separate and distinct cause of action for mistreatment of insureds. Thus, where an insurer "unreasonably" and "in bad faith" breached an insurance agreement, it became liable not only for contract damages, but in tort as well.

(2) At the time the conduct at issue herein occurred, the California doctrine of tortious breach had been applied only to liability insurance coverage and not to "first-party" insurance coverage.[8] Thus, for example, where an insurer unreasonably failed to protect an insured's interest in avoiding excess liability for third-party claims, a tort action would lie. *Crisci*, 66 Cal. 2d at 432-34.

(3) Where an insurer's breach of this duty was found to have been committed with "oppression, fraud or malice,"

[8]Months after the dispute between Egan and Mutual, but before trial of the issues, California courts extended the tortious breach doctrine to "first-party" coverage as well. *See Richardson v. Employers Liab. Assurance Corp.*, 25 Cal. App. 3d 232, 239 (1972). One earlier intermediate court opinion, *Fletcher v. Western Nat'l Life Ins. Co.*, 10 Cal. App. 3d 376, 401-02 (1970), had suggested the potential applicability of the tortious breach doctrine to first-party claims, but this was no more than *dictum*, since extra-contract liability in *Fletcher* was based solely on intentional infliction of emotional distress.

civil punishment under the state's punitive damages law[9] was authorized but not required.

The Decisions In This Case

At trial and on appeal, Mutual was held to a higher standard of duty than California courts had previously announced:

(1) At trial, the court directed a verdict against Mutual on the issue of tortious breach of the covenant of good faith and fair dealing. In affirming this ruling, the California Supreme Court held for the first time that, as a matter of law:

> [A]n insurer cannot reasonably and in good faith deny payments to its insured without thoroughly investigating the foundation for its denial.

Opinion below, p. A-8 *infra*.

(2) Therefore, since Mutual did not "fully inquire into possible bases that might support the insured's claim," the only issues actually submitted to the jury were causation, the amount of compensatory damages and whether and in what amount to impose punitive damages. *Id.*

(3) Thus, if Mutual was found "guilty of oppression or fraud or actual malice,"[10] the jury was instructed:

[9]Cal. Civ. Code § 3294. Such punishment was authorized despite the fact that § 3294 is on its face limited to "obligation[s] not arising from a contract."

[10]Section 3294's requirement of "oppression, fraud or malice" is not a standard for the imposition of punitive damages but, rather, a condition precedent thereto. That condition having been met, the jury must still decide whether a punitive award is appropriate and, if so, in what amount. In this case, one indication of the trial court's lack of awareness of the new ground it had broken is its misdefinition of fraud (for Section 3294 purposes) as an act "whereby one person gains an advantage over another by means of . . . bad faith." Cl. Tr. 485. Since the court had already told the jury Mutual was guilty of tortious bad faith as a matter of law, this definition may reasonably have been interpreted by the jury as directing a finding that the condition precedent to an award of punitive damages had been established as well.

> [Y]ou may in your sole discretion award . . . punitive or exemplary damages, for sake of example and by way of punish[ment]. . . . The law provides no fixed standard as to the amount of such punitive damages.

Cl. Tr. 485-86.

The resulting jury verdict was against Mutual for $45,600 in contract benefits for plaintiff's 18-year life expectancy, $78,000 in tort based upon mental and emotional distress and $5,000,000 in punitive damages. On appeal, the California Supreme Court found substantial evidence supporting the jury's decision to assess punitive damages against Mutual[11] but held the magnitude of the actual award excessive as a matter of law and remanded the punitive damages issues for retrial. Opinion below, pp. A-15 - A-16 *infra*.

THE QUESTIONS ARE SUBSTANTIAL

Although the effect of punitive damages is often criticized,[12] a state's power to permit juries to make such awards in some circumstances has been assumed at least since

[11]Although judgments against McEachen and Segal were entered at trial, these were reversed by the California Supreme Court on the ground that, as Mutual's agents, McEachen and Segal were not parties to the insurance contract. *See* opinion below, p. A-16 *infra*. The interests of these individual defendants are thus unaffected by the resolution of the issues raised by this appeal.

[12]*See, e.g., International Bhd. of Elec. Workers v. Foust*, 47 U.S.L.W. 4600, 4601-02 (U.S. May 29, 1979) (prohibiting punitive damages in state court "unfair representation" actions brought under the Federal Railway Labor Act); *International Union, U.A., A. & A.I.W. v. Russell*, 356 U.S. 634, 651-58 (1958) (Warren, C.J., dissenting from an affirmance of punitive damages awarded for a

Day v. Woodworth, 54 U.S. (13 How.) 363 (1851).[13] But from the outset, this Court has recognized that the exercise of that power must be limited by adequate definition of the civil wrong to be punished.[14] Moreover, where a civil wrong is defined after-the-fact,[15] this Court gave early warning

federal unfair labor practice also actionable as a tort in a state court); McCormick, *Handbook on the Law of Damages* 275-76 (1935). McCormick writes: "To many judges and commentators the doctrine which sanctions such punishment [punitive damages] has seemed a discordant strain disturbing the harmonious symphony of the law of damages of which the central theme is compensation." *Id.* at 275. McCormick concludes: "It is probable that, in the framing of a model code of damages today . . . the doctrine of exemplary damages would find no place." *Id.* at 276.

[13]The *Day* Court relied on "common law . . . decisions . . . received" as establishing the legitimacy of state punitive awards in "all actions on the case for torts." 54 U.S. at 371. This proposition was, apparently, never so clear at British common law. *See Rookes v. Barnard,* [1964] A.C. 1129, *semble.* What is clear, after *Rookes,* is that such awards may not be made in the United Kingdom except (1) in a limited class of intentional torts, (2) where malfeasance by "government servants" causes injury, or (3) where a statute "expressly authorizes" such punishment for described acts. *Id.* at 1226-33.

[14]*See, e.g., Philadelphia, W. & B.R.R. v. Quigley,* 62 U.S. (21 How.) 202 (1859) (action for libel: punitive damage award reversed where trial court's instruction failed to limit jury discretion); *Milwaukee & St. P. Ry. v. Arms,* 91 U.S. (1 Otto) 489 (1876) (action for personal injury; same).

[15]In this case, appellant was held subject to enormous and wholly discretionary punishment in tort for breach of a previously nonexisting duty. Clearly distinguishable are instances where a nominal penalty—fixed by statute—is automatically assessed for failure to pay a contract claim found valid at trial. *See, e.g., Life & Cas. Ins. Co. v. McCray,* 291 U.S. 566 (1934) (upholding an Arkansas statute providing a 12% increment above actual loss where the "insurance company liable therefor shall fail to pay . . . within the time specified in the policy"); *Yazoo & M.V.R.R. v. Jackson Vinegar Co.,* 226 U.S. 217 (1912) (upholding a Mississippi statute providing "twenty five dollars . . . in addition to actual damages" where a common carrier failed to settle a claim within a stated time). Characterizing such statutes as "a tax upon default" and "a stimulus to settlement," Mr. Justice Cardozo for the *McCray* Court held that "the Fourteenth Amendment does not prohibit a fixed award of [such] damages, moderate in amount . . . when . . .

that punishment might be constitutionally foreclosed, although a state could impose ordinary liability in appropriate circumstances. *Chicago & Alton Railroad v. Tranbarger,* 238 U.S. 67 (1915).[16] More recently, this Court has had occasion to consider the constitutionality of state punitive damage awards in a First Amendment context and has held that protected rights are impermissibly chilled where a state permits juries to make punitive awards for defamation, at least where explicit "actual malice" is not shown. *Gertz v. Robert Welch, Inc.,* 418 U.S. 323, 349 (1974). No more is settled, therefore, than that state juries may penalize well-defined civil wrongs by assessing punitive damages—and that such power is, in at least some circumstances, subject to constitutional limitations.

Under California law, by contrast, there is no statutory definition of the civil wrongs which may be punished by punitive damages and no instructions may be given to limit or guide jury discretion. What gives this case special bite is the fact that the civil wrong punished was itself created by the California courts and retrospectively applied to appellant. Where, as here, such a judicial expan-

payment . . . has been wrongfully refused." 291 U.S. at 570. But where awards may be "so heavy as to erect an unfair barrier against [litigation]," the *McCray* Court said, "the Constitution intervenes." *Id.* at 574-75.

[16]In *Tranbarger,* this Court upheld a penalty feature of a state law, which created a new statutory duty to build drains into railroad roadbeds, against an attack arguing, *inter alia,* that the statute could not impose "*ex post facto*" punishment for a railroad's preenactment failure to install the specified drains. Recognizing the constitutional difficulty inherent in retrospective application of such a statute, the *Tranbarger* Court construed away the problem by reading the civil penalty provision as applicable only to continuation, after enactment of the statute, of the newly prohibited preexisting condition. 238 U.S. at 72-73.

sion of tort law may result in a multi-million dollar penalty to punish conduct which, before judgment, had appeared insufficient to support even ordinary liability in tort, four separate and substantial constitutional issues are presented.

1. Void For Vagueness

California's punitive damages law is, on its face, devoid of standards. In the context of insurance agreements, the principal purpose of Section 3294 is "to deter acts deemed socially unacceptable." Opinion below, p. A-9 *infra*. Where an insurer is held to have tortiously breached a California insurance contract, the application of Section 3294 permits, but does not require, a jury to impose punishment "in addition to actual damages" if it finds that "the defendant has been guilty of oppression, fraud or malice."[17] Thus the decision *whether* to punish the defendant for its conduct at all, as well as the determination of *how much* punishment to impose, is "wholly within the control of the jury." Opinion below, p. A-11 *infra*. Indeed, the California Supreme Court has explicitly forbidden trial courts to limit or guide, by instructions, the "untrammeled discretion" of the jury to award punitive damages under Section

[17]California juries are routinely instructed, as in this case, that malice means "a motive or willingness to vex, harass, annoy or injure another person," and malice may be shown, for example, by "conduct . . . done with a conscious disregard of another's rights." *See, e.g.*, instructions at trial below, Cl. Tr. 485. Similarly, California juries are told that oppression means "subjecting a person to cruel and unjust hardship in conscious disregard of his rights." *Id.* at 486. Fraud is conventionally defined in terms of an "act fitted to deceive" or conduct which "mislead[s] another to his prejudice." *See, e.g.*, Cal. Civ. Code §§ 1572, 1573; *cf.* n.9 *supra*.

3294. *Brewer v. Second Baptist Church*, 32 Cal. 2d 791, 801 (1948).[18]

In *Herndon v. Lowry*, 301 U.S. 242, 263-64 (1937), this Court recognized that where a statute "licenses the jury to create its own standard in each case," and state courts do not narrow by construction the license so provided, the potential for arbitrary, erratic and discriminatory verdicts conflicts with settled constitutional principles. Similarly, in *Giaccio v. Pennsylvania*, 382 U.S. 399, 403 (1966), this Court found a violation of due process in a statute giving juries in criminal cases[19] the unlimited power to apportion costs between the parties or assess them against an acquitted defendant and held that "implicit in this constitutional safeguard is the premise that the law must be one that carries an understandable meaning with legal standards that courts must enforce." The Court acknowledged the state's interest in deterring conduct "not reprehensible enough for a criminal conviction but sufficiently reprehensible to deserve . . . some penalty short of conviction," but it found jury instructions to that effect insufficient to save the statute because they still left the jury to "make determinations of the crucial issue upon their own notions of what the law should be instead of what it is." *Id.* at 403-04.

[18]According to the *Brewer* court: "The granting or withholding of the award of punitive damages is wholly within the control of the jury, and *may not legally be influenced by any direction of the court*". 32 Cal. 2d at 801 (emphasis added).

[19]In disposing of the state's contention that due process was not invoked because the Act was "not a penal statute" but of a "civil character," the *Giaccio* Court recognized that such labeling "does not go far towards settling the constitutional question," and that the "Act whether labeled 'penal' or not must meet the challenge that it is unconstitutionally vague." 382 U.S. at 402; *see A. B. Small Co. v. American Sugar Ref. Co.*, 267 U.S. 233, 239 (1925).

California's punitive damages statute appears to fall squarely within the reasoning of *Herndon* and *Giaccio* since, as written and as construed, Section 3294 clearly "licenses a jury" to make punishment decisions "upon their own notions of what the law should be." The question here is whether so vague a statutory scheme can be employed to deter "socially unacceptable" acts without eviscerating the due process rights of all those who must guess whether their conduct is punishable and to what degree.

2. Prohibited Retrospective Application

If, after the present action was filed, California had enacted a statute creating an affirmative duty in each insurer to investigate independently the medical basis of all claims by its insureds and to "fully inquire into possible bases that might support" such claims, it is doubtful that any court would hold that such a statute created a new cause of action in tort for omissions occurring years before. Although, in some circumstances, judicial expansion of existing law may have retroactive application where legislation may not, there are constitutional limits to the fiction that such "construction" by a court merely makes explicit in the present what had been implicit in a statute from the date of its enactment. *See, e.g., Brinkerhoff-Faris Trust & Savings Co. v. Hill,* 281 U.S. 673 (1930).[20] *See also Shelley v. Kraemer,* 331 U.S. 1, 14-18 (1948).

Appellant does not challenge the California courts' power to expand the tort of bad faith. Nor is there a challenge

[20]In *Brinkerhoff,* this Court found a denial of due process where a state injunction was dissolved because of an adequate remedy at law, where the existence of that remedy was announced for the first time in the opinion below.

here to the retroactive application of the expanded tort doctrine to create the *ordinary* liability: appellant concedes that it may be required to recompense its insured for actual injury resulting from appellant's breach in 1970-71 of a then non-existing duty.

But punishment is a different matter.

Certainly a state may not, by later penal enactment, constitutionally punish a criminal defendant for an antecedent "violation." *Calder v. Bull,* 3 U.S. (3 Dall.) 386 (1798). Similarly, the Due Process Clause prevents punishment of a defendant charged under a penal statute too vague to give fair warning of the conduct it prohibits, where a saving judicial construction is announced in his own case or thereafter. *Lanzetta v. New Jersey,* 306 U.S. 451, 456 (1939). By the same reasoning an unforeseeable judicial enlargement of a criminal statute may not be applied retroactively. *Bouie v. Columbia,* 378 U.S. 347, 352-54 (1964).

To be sure, this case involves punishment of a civil wrong; but it is retrospective punishment nonetheless. And while such punishment may not be proscribed by the Ex Post Facto Clause,[21] this Court has recognized that, if "harsh and oppressive," it may be barred by the Due Process Clause. *United States Trust Co. v. New Jersey,* 431 U.S. 1, 17 n.13 (1977); *Welch v. Henry,* 305 U.S. 134,

[21]No case has been found squarely holding that punitive damages are *not* punishment falling within the ambit of Article I, Section 10 of the Constitution. And the opinion of this Court in *Tranbarger* appears to suggest that retrospective imposition of civil penalties may be forbidden by the Ex Post Facto Clause. 238 U.S. at 72-73.

147 (1938). Further, in *Usery v. Turner Elkhorn Mining* Co.,[22] 428 U.S. 1, 17-18 (1976), this Court has said:

> We would . . . hesitate to approve the retrospective imposition of liability on any theory of deterrence . . . or of blameworthiness. (Citations omitted.)

Since it is manifest that the purpose of California's application of its punitive damages statute to appellant in this case was "to deter acts deemed socially unacceptable," opinion below, p. A-9 *infra,* and since the punitive damages authorized by that statute may surely be categorized as "harsh and oppressive," this case squarely raises the question foreshadowed by *Turner Elkhorn* and *United States Trust*: May a state impose punitive damages for conduct retrospectively declared wrongful, without violating the Due Process Clause?

3. Impermissible Burden on Access to Court

Reasonable access to the courts is guaranteed by the Due Process Clause. *Boddie v. Connecticut,* 401 U.S. 371 (1971). The rule is that

> absent a countervailing state interest of overriding significance, persons forced to settle their claims of right and duty through the judicial process must be given a meaningful opportunity to be heard.

[22]In *Turner Elkhorn,* this Court upheld, on a cost-spreading rationale, the retrospective aspects of the Federal Coal Mine Health and Safety Act of 1969, 83 Stat. 792, as amended by the Black Lung Benefits Act of 1972, 86 Stat. 150, 30 U.S.C. §§ 901 *et seq.* (1970 & Supp. IV). This legislation imposed ordinary liability—with payments to be shared by the federal government —for injuries resulting *inter alia* from exposure to mine conditions not prohibited before the Act.

Id. at 377. Thus where the price of going to court is too high, access to judicial process is impermissibly denied. *See also Ex parte Young,* 209 U.S. 123 (1908).

In the same vein, this Court has recognized that, in some circumstances, statutory penalties imposed where an insurer litigates and loses a contract claim may be "so heavy as to erect an unfair barrier against the endeavor of an honest litigant to obtain the judgment of a court." *Life & Casualty Insurance Co. v. McCray,* 291 U.S. 566, 574 (1934). Such penalties may be unconstitutional where imposition would deter a corporation's efforts to test in court the validity or applicability of a duty imposed by legislation,[23] as well as where such imposition would deter a party from testing a duty imposed by administrative order.[24]

As the *Boddie* Court noted, "due process of law signifies a right to be heard in one's defense." 401 U.S. at 377. This case raises the question whether a corporation has such a due process right to be free from the threat of arbitrary punishment so heavy as to effectively deter defense on the merits of a contract dispute. And even if such a right does not exist in general, whether a state impermissibly chills access to its courts when it permits enormous punitive damages for breach of a judicially enunciated duty, which—

[23]*See Wadley S. Ry. v. Georgia,* 235 U.S. 651, 659, 661-62 (1914); *Missouri P.R.R. v. Tucker,* 230 U.S. 340, 349 (1913); *Ex parte Young,* 209 U.S. 123, 147 (1908).

[24]*See Natural Gas Pipeline Co. v. Slattery,* 302 U.S. 300, 310 (1937); *Willcox v. Consolidated Gas Co.,* 212 U.S. 19 (1909).

before trial—could not have been supposed to form the basis for such a penalty.[25]

4. Impermissible Burden On Protected Speech

Punitive damages are "private fines by civil juries to punish reprehensible conduct and to deter its future occurrence." *Gertz v. Robert Welch, Inc.*, 418 U.S. 323, 350 (1974). But where the conduct thus deterred is the exercise of an ordinarily protected constitutional right which, through injury to another, may result in a state court damage award at trial, this Court has recognized that "jury discretion to award punitive damages unnecessarily exacerbates the danger of . . . self censorship." *Id.* Thus, state courts are now forbidden to award punitive damages in defamation actions, at least absent "actual malice," because of the undeniably chilling effect such potentially large awards may have on First Amendment rights.

Corporate speech is not less protected, because of its source, than individual speech. *First National Bank v. Bellotti,* 435 U.S. 765, 784 (1978). And "even communications which have no purpose other than that of enriching the communicator have some First Amendment protection." *Id.* at 805 (White, J., dissenting); *see Virginia State Board*

[25]No "countervailing state interest of overriding significance" appears to justify the application of California's punitive damages scheme to permit multi-million dollar punishment in this case. Indeed the California Supreme Court, which has "looked with disfavor on ever-mounting penalties," has recently held that even an explicit statutory fine for clearly defined prohibited conduct may offend due process by the very magnitude of the penalty. *Hale v. Morgan,* 22 Cal. 3d 388 (1978) (statutory provision mandating $100-a-day penalty where landlord unjustifiably interrupts tenant's utility service held "arbitrary, excessive and unreasonable" and therefore violative of due process, where penalty for continuing violation reached $17,300).

of Pharmacy v. Virginia Citizens Consumer Council, Inc., 425 U.S. 748 (1976). Thus where, in the course of business, a dispute arises between an insurer and its insured over their respective rights and duties, each would appear to have an equal constitutional right to express his position and the reasons and beliefs upon which it is based.

The question here is whether, in the dispute with its insured, appellant's assertion of its position, in person and by letter, amounts to protected communication[26] within the ambit of the First Amendment. And if so, whether California courts may, as here, construe and apply Section 3294 to permit punishment of such protected communication, absent a showing of "actual malice"[27] greater than can be inferred from appellant's failure to rise to a duty explicated for the first time at its trial.

Summary

In recent years, California courts have substantially altered California contract law. By implying an unwritten covenant of good faith in every transaction, a separate

[26]It may be argued that appellant's dealings with its insured constituted conduct and not speech. But while Mutual's liability for compensatory damages was based on its failure to investigate Egan's claim, *punishment* required as a predicate "oppression, fraud or malice," which it seems the jury could have found—if at all—only in appellant's communications with its insured. *See* opinion below, pp. A-11 - A-12, A-23 - A-28 *infra*. Moreover, the speech-conduct distinction is of questionable significance where the actor seeks, in any event to communicate and advance his position. *Cf. Buckley v. Valeo,* 424 U.S. 1, 14-23 (1976) (statutory limitations on the giving and spending of money in political campaigns cannot withstand First Amendment attack on the ground that such provisions merely regulate conduct).

[27]Mere failure to investigate cannot, of course, be equated with "actual malice" in the usual First Amendment context. *See Garrison v. Louisiana,* 379 U.S. 64 (1964); *Beckley Newspapers v. Hanks,* 389 U.S. 81 (1967).

cause of action in tort for breach of covenant has been added to traditional contract remedies. And by construing the duties owed under such a covenant as "not arising from a contract," Section 3294, which authorizes a jury to award punitive damages in tort actions, has been held applicable to "bad faith" failure to discharge contractual obligations where oppression, fraud or malice is shown.

With respect to insurance agreements, the insurer's "good faith" responsibility to its insureds was first held to extend beyond usual contractual duties where a third party's claims might subject the insured to liability beyond the policy limits of his coverage. After the present action was filed, that responsibility was extended to claims of the insured himself where his insurer "unjustifiably" refused "payment of an indisputedly valid claim,"[28] or where an insurer had, for example, "encouraged criminal charges by falsely implying" that its insured had committed arson.[29] In the opinion below, the insurer's duty was expanded to include an obligation, beyond reliance on its insured's documentation and medical records, to investigate thoroughly "possible bases that might support the insured's claim." For breach of that duty, appellant was held liable in tort and subject to punitive damages.

For the reasons set forth above, appellant submits that the standardless and retrospective application of a statute so broadly worded as Section 3294, to punish conduct not previously declared tortious, runs roughshod over

[28] *Richardson v. Employers Liab. Assurance Corp.*, 25 Cal. App. 3d 232, 245 (1972).

[29] *Gruenberg v. Aetna Insur. Co.*, 9 Cal. 3d 566, 575 (1973).

appellant's right to due process, and chills the protected interests of any party to a contract who may in the future wish to set forth his position in words or pursue his right to judicial determination of that position. The absence of any discernible state interest in the *punishment* of appellant's previously non-tortious conduct only adds substantially to the Fourteenth and First Amendment claims.

CONCLUSION

It is respectfully submitted that the questions presented by this appeal are substantial, requiring plenary consideration, and that probable jurisdiction should be noted by this Court.

Dated: San Francisco, California
January 9, 1980

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Of Counsel

Appendices Follow

Appendices

Appendix A

In the Supreme Court of the
State of California

L.A. No. 30747. Aug 14, 1979

Michael Egan,
Plaintiff and Respondent,
vs.
Mutual of Omaha Insurance Company
et al.,
Defendants and Appellants.

OPINION

MOSK, J.—Defendants appeal from a judgment awarding compensatory and punitive damages for breach of an insurance contract. We conclude the judgment should be affirmed insofar as it awards compensatory damages against defendant Mutual of Omaha Insurance Company (Mutual) but reversed in all other respects.

In 1962, plaintiff purchased a health and disability insurance policy from defendant Mutual through its Los Angeles representative, the Hall-Worthing Agency (agency). The policy provided for lifetime benefits of $200 per month in event the insured became totally disabled as a result of either an accidental injury "independent of sickness and other causes" or sickness sufficiently severe to cause confinement of the insured to his residence. Benefits for a nonconfining illness were payable for a period not to exceed three months.

Between 1963 and 1970 plaintiff claimed and received payments for three separate back-related disabling injuries. In May 1970, he made a fourth claim for accidental back injury suffered during the course of his employment. Portions of the claim form were completed by both plaintiff and his physician. The physician estimated plaintiff would be able to return to work in August 1970. In September plaintiff visited the agency and discussed his claim. This discussion resulted in payment under the policy's accident provisions for a three-month period following date of injury.

Plaintiff filed a supplemental claim in October 1970, stating he was unable to return to work. Because his physician indicated on the claim form that plaintiff could have returned to work on September 29, defendant McEachen, an agency claims manager, reviewed workers' compensation and State Compensation Insurance Fund medical records. These records disclosed that plaintiff and the examining physician had agreed he would return to work on July 1, 1970.

On November 20, McEachen visited plaintiff at home. McEachen testified he merely discussed contradictions in the claim form and agreed to discuss the matter later after further investigation. Plaintiff testified that McEachen informed him no further benefits were due because he was not actually disabled but simply unable to find work, that he told McEachen employment was available through his labor union but because he still suffered from his injury he was unable to accept such employment, and that he was willing to be examined by any doctor of Mutual's choice.

In February 1971, as a result of inquiry from Mutual's

home office, McEachen addressed a letter to plaintiff enclosing payment of benefits through September 29, 1970. The letter stated the check represented full payment of benefits due under the policy.

On February 26, 1971, surgery was performed on plaintiff's back, and he submitted another claim to the agency. The physician's portion of this claim form included an estimate by the surgeon that plaintiff could return to work "Possibly 3-6 months from date of surgery." This claim was assigned to defendant Segal, an agency claims adjuster, who was aided in his field investigations by claims analyst Romano from Mutual's home office. Although not entirely clear, it appears Romano was assigned to the agency to assist in a backlog of field investigations. Romano was not Segal's superior; rather, he occupied a position equivalent to that of Segal in the agency.

Segal and Romano, in the course of their field investigations, reviewed records of Workers' Compensation Appeals Board, State Compensation Insurance Fund, and the hospital where plaintiff's surgery was performed. State Compensation Insurance Fund records contained letters from Dr. Carpenter, plaintiff's surgeon, and Dr. Singelyn. Dr. Carpenter wrote in his letter: "[Plaintiff's medical] history appears consistent with a man with probable discogenic disease with multiple aggravations over the last several years, finally culminating in a specific incident a little over seven months ago. . . ." Dr. Singelyn declared in his letter: "I would apportion 50% of his current subjective complaints to his industrial injury, and 50% to the natural progression of his preexisting pathology of degenerative wear and tear osteoarthritis of the spine." Neither Segal

nor Romano made any effort to contact plaintiff's physicians. Trial testimony established that efforts to discuss the case with attending physicians would ordinarily have been made by a claims adjuster. Based on Segal's review of medical records, plaintiff's condition was reclassified from injury to nonconfining illness.

In May 1971 Segal visited plaintiff at home, telling him he suffered from an illness, not an injury. Segal handed plaintiff a check for medical costs and three months maximum disability payments. Plaintiff did not cash the check. He testified he refused Segal's offer for a larger check if plaintiff would surrender his policy. He further testified that after discussing the matter with Dr. Carpenter, he wrote to Segal concerning his reclassification but received no answer.

Segal testified he was certain he acted at the direction of some higher authority during the May 1971 meeting, although he could not recall who directed him. Mutual's files contained no written directive to Segal. Gustin, head of Mutual's continuing disability claims division, attempted to explain the absence of any identifiable person in authority at Mutual's home office to receive and review Segal's reports. He testified plaintiff's file had not been in his department after December 1970, and that it may have "fallen . . . into a crack."

Subsequently, plaintiff received a 73 percent disability rating on his workers' compensation claim. Not returning to work, he remained under medical care. In July 1972, at plaintiff's request, the Department of Insurance asked Mutual to review plaintiff's file and report to the department within 15 days. The nature of Mutual's response, if any, is unclear; it was not produced at trial.

In 1973, plaintiff commenced the present action for compensatory and punitive damages against Mutual, Segal and McEachen. The trial court, in directing a verdict against defendants, ruled as a matter of law that defendants' failure to have plaintiff examined by a doctor of their choice or to consult with plaintiff's treating physicians and surgeon violated the covenant of good faith and fair dealing. The court submitted to the jury the issues of causation, compensatory and punitive damages. The jury returned verdicts against all defendants. General damages of $500 and punitive damages of $400 were assessed against Segal. General damages of $1,000 and punitive damages of $500 were assessed against McEachen. Mutual was held liable for $45,600 in general damages, $78,000 for emotional distress, and $5 million in punitive damages.

I

The directed verdict on the issue of breach of covenant of good faith and fair dealing rests on Mutual's inadequate investigation of plaintiff's claim. Mutual argues that an insurer violates this covenant in a disability insurance contract only if it wrongfully denies a claim knowing it has no reasonable basis for doing so, and that the ruling herein improperly subjects it to strict liability in tort for breach of contract. We disagree. For the reasons discussed below, we conclude that an insurer may breach the covenant of good faith and fair dealing when it fails to properly investigate its insured's claim.

In addition to the duties imposed on contracting parties by the express terms of their agreement, the law implies in every contract a covenant of good faith and fair dealing. (*Comunale* v. *Traders & General Ins. Co.* (1958) 50 Cal.2d 654, 658 [328 P.2d 198, 68 A.L.R.2d 883]; see also Comment, *Extending the Insurer's Duty of Good Faith and Fair Dealing to Third Parties Under Liability Insurance Policies* (1978) 25 UCLA L.Rev. 1413, 1418-1424.) The implied promise requires each contracting party to refrain from doing anything to injure the right of the other to receive the benefits of the agreement. (*Murphy* v. *Allstate Ins. Co.* (1976) 17 Cal.3d 937, 940 [132 Cal.Rptr. 424, 553 P.2d 584]; *Crisci* v. *Security Ins. Co.* (1967) 66 Cal.2d 425, 429 [58 Cal.Rptr. 13, 426 P.2d 173]; *Comunale* v. *Traders & General Ins. Co., supra,* 50 Cal.2d at p. 658.) The precise nature and extent of the duty imposed by such an implied promise will depend on the contractual purposes.

This court has previously addressed the extent of the duties imposed by the implied covenant in liability insurance policies. (*Johansen* v. *California State Auto Assn. Inter-Ins. Bureau* (1975) 15 Cal.3d 9 [123 Cal.Rptr. 288, 538 P.2d 744]; *Crisci* v. *Security Ins. Co., supra,* 66 Cal.2d 425; *Comunale* v. *Traders & General Ins. Co., supra,* 50 Cal.2d 654.) We there held that the insurer, when determining whether to settle a claim, must give at least as much consideration to the welfare of its insured as it gives to its own interests. The governing standard is whether a prudent insurer would have accepted the settlement offer if it alone were to be liable for the entire judgment. (*Johansen,* at p. 16 of 15 Cal.3d; *Crisci,* at p. 429 of 66 Cal.2d.)

The standard is premised on the insurer's obligation to protect the insured's interests in defending the latter against claims by an injured third party.

The implied covenant imposes obligations not only as to claims by a third party but also as to those by the insured. (*Silberg* v. *California Life Ins. Co.* (1974) 11 Cal. 3d 452 [113 Cal.Rptr. 711, 521 P.2d 1103]; *Gruenberg* v. *Aetna Ins. Co.* (1973) 9 Cal.3d 566 [108 Cal.Rptr. 480, 510 P.2d 1032].) In both contexts the obligations of the insurer "are merely two different aspects of the same duty." (*Gruenberg* v. *Aetna Ins. Co., supra,* 9 Cal.3d at p. 573; accord, *Silberg* v. *California Life Ins. Co., supra,* 11 Cal.3d 452; *Fletcher* v. *Western National Life Ins. Co.* (1970) 10 Cal.App.3d 376 [89 Cal.Rptr. 78, 47 A.L.R.3d 286].) "[W]hen the insurer unreasonably and in bad faith withholds payment of the claim of its insured, it is subject to liability in tort." (*Gruenberg,* at p. 575 of 9 Cal.3d; accord, *Silberg,* at p. 461 of 11 Cal.3d; *Fletcher,* at pp. 401-402 of 10 Cal.App.3d.) For the insurer to fulfill its obligation not to impair the right of the insured to receive the benefits of the agreement, it again must give at least as much consideration to the latter's interests as it does to its own. (*Silberg,* at p. 460 of 11 Cal.3d.)

The insured in a contract like the one before us does not seek to obtain a commercial advantage by purchasing the policy—rather, he seeks protection against calamity. As insurers are well aware, the major motivation for obtaining disability insurance is to provide funds during periods when the ordinary source of the insured's income—his earnings—has stopped. The purchase of such

insurance provides peace of mind and security in the event the insured is unable to work. (See *Crisci* v. *Security Ins. Co., supra,* 66 Cal.2d at p. 434.) To protect these interests it is essential that an insurer fully inquire into possible bases that might support the insured's claim. Although we recognize that distinguishing fraudulent from legitimate claims may occasionally be difficult for insurers, especially in the context of disability policies, an insurer cannot reasonably and in good faith deny payments to its insured without thoroughly investigating the foundation for its denial.

Here the evidence is undisputed that Mutual failed to properly investigate plaintiff's claim; hence the trial court correctly instructed the jury that a breach of the implied covenant of good faith and fair dealing was established.

II

Civil Code section 3294 provides: "In an action for the breach of an obligation not arising from contract, where the defendant has been guilty of oppression, fraud, or malice, express or 'implied, the plaintiff, in addition to the actual damages,' may recover damages for the sake of example and by way of punishing the defendant." Section 3294 was originally enacted in 1872, a minor amendment was adopted in 1905, and the statute has remained intact ever since. It is true that the concept of punitive damages has been criticized;[1] but unless at this late date we were

[1]See, e.g., Long, *Punitive Damages: An Unsettled Doctrine* (1976) 25 Drake L.Rev. 870; Carsey, *The Case Against Punitive Damages* (1975) 11 The Forum 57; Ghiardi, *The Case Against Punitive Damages* (1972) 8 The Forum 411; Note, *The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages* (1966) 41 N.Y.U.L.Rev. 1158.

to hold the section unconstitutional—a proposition that has been frequently rejected (see, e.g., *Fletcher* v. *Western National Life Ins. Co., supra,* 10 Cal.App.3d at pp. 404-405; *Toole* v. *Richardson-Merrell Inc.* (1967) 251 Cal.App. 2d 689, 719 [60 Cal.Rptr. 398, 29 A.L.R.3d 988]; *United States* v. *Regan* (1914) 232 U.S. 37, 46-49 [58 L.Ed. 494, 497-499, 34 S.Ct. 213])—we cannot usurp the Legislature's determination that such damages should be recoverable in cases in which the statutory prerequisites are fulfilled. (*Merlo* v. *Standard Life & Acc. Ins. Co.* (1976) 59 Cal. App.3d 5, 19-20 [130 Cal.Rptr. 416]; *Ferraro* v. *Pacific Fin. Corp.* (1970) 8 Cal.App.3d 339, 355 [87 Cal.Rptr. 226].)

In the present context, the principal purpose of section 3294 is to deter acts deemed socially unacceptable and, consequently, to discourage the perpetuation of objectionable corporate policies. (See *Ferraro v. Pacific Fin. Corp., supra,* 8 Cal.App.3d at p. 353 [punitive award to deter corporate policy of repossessing automobiles despite bona fide claims of ownership by third parties].) Traditional arguments challenging the validity of exemplary damages lose force when a punitive award is based on this justification. The special relationship between the insurer and the insured illustrates the public policy considerations that may support exemplary damages in cases such as this.

As one commentary has noted, "The insurers' obligations are . . . rooted in their status as purveyors of a vital service labeled quasi-public in nature. Suppliers of services affected with a public interest must take the public's interest seriously, where necessary placing it before their interest in maximizing gains and limiting disbursements

. . [A]s a supplier of a public service rather than a manufactured product, the obligations of insurers go beyond meeting reasonable expectations of coverage. The obligations of good faith and fair dealing encompass qualities of decency and humanity inherent in the responsibilities of a fiduciary. Insurers hold themselves out as fiduciaries, and with the public's trust must go private responsibility consonant with that trust." (Goodman & Seaton, *Foreword: Ripe for Decision, Internal Workings and Current Concerns of the California Supreme Court* (1974) 62 Cal. L.Rev. 309, 346-347.) Furthermore, the relationship of insurer and insured is inherently unbalanced; the adhesive nature of insurance contracts places the insurer in a superior bargaining position. The availability of punitive damages is thus compatible with recognition of insurers' underlying public obligations and reflects an attempt to restore balance in the contractual relationship. (Hirsch et al., *Strict Liability: A Response to the Gruenberg-Silberg Conflict Regarding Insurance Litigation Awards* (1975) 7 Sw.U.L.Rev. 310, 326; Comment, *Egan* v. *Mutual of Omaha Insurance Co.: The Expanding Use of Punitive Damages in Breach of Insurance Contract Actions* (1978) 15 San Diego L.Rev. 287, 298-301; Note, *Contracting for Punitive Damages: Fletcher* v. *Western National Life Insurance Company* (1971) 4 Loyola L.A. L.Rev. 208, 219-224.)

On this appeal, of course, we are governed by the familiar substantial evidence test of *Crawford* v. *Southern Pacific Co.* (1935) 3 Cal.2d 427, 429 [45 P.2d 183]. Determinations related to assessment of punitive damages have traditionally been left to the discretion of the jury; *Davis*

v. *Hearst* (1911) 160 Cal. 143, 173 [116 P. 530], declares them to be "wholly within the control of the jury." (See also *Ferraro* v. *Pacific Fin. Corp., supra,* 8 Cal.App.3d at p. 351; *Sullivan* v. *Matt* (1955) 130 Cal.App.2d 134, 143-144 [278 P.2d 499].)[2] Here the propriety of punitive damages was also reviewed by the trial court when it rejected both defendants' motion for new trial and their motion for judgment notwithstanding the verdict. A brief analysis of the record convinces us that substantial evidence supports the jury's decision to assess punitive damages.

Plaintiff received his first payment from Mutual on the claim in issue herein only after a long delay and a personal visit to the claims office. When he requested additional payments as a result of his continuing inability to work, McEachen visited him at his home. Testimony was introduced that McEachen, although aware of plaintiff's good faith efforts to work, called plaintiff a fraud and told him that he sought benefits only because he did not want to return to work. McEachen advised plaintiff he was not entitled to any further payments and that past benefits received were also unwarranted, despite plaintiff's bona fide claim of accidental injury.[3] When plaintiff expressed his concern regarding the need for money during the approaching Christmas season and offered to submit to examination by a physician of Mutual's choice, McEachen only laughed,

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[2]Restatement Second of Torts, section 908, comment (d), includes the statement, "Whether to award punitive damages and the determination of the amount are within the sound discretion of the trier of fact, whether judge or jury."

[3]McEachen substantiated this assertion by claiming to have contacted plaintiff's treating physician, a claim not supported by the record.

reducing plaintiff to tears in the presence of his wife and child.

After plaintiff received what Mutual designated his "final" payment, he was compelled to undergo back surgery. Segal visited plaintiff after he made further requests for total disability payments because he was confined to his home for medical reasons. Segal told him that he was not incapacitated from an accidental injury but had a "sickness" that could not qualify under the policy's total disability provision. Despite the lack of support for denying plaintiff's disability claim, Segal offered a "final" check under the policy's sickness provision, or a larger check if plaintiff would surrender the policy.[4] Other evidence reflected both Segal's and McEachen's knowledge that plaintiff had a 12-year-old child and a totally disabled wife. In short, the record as a whole contains substantial evidence from which the jury might reasonably find that defendant "acted maliciously, with an intent to oppress, and in conscious disregard of the rights of its insured." (*Neal* v. *Farmers Ins. Exchange* (1978) 21 Cal.3d 910, 923 [148 Cal.Rptr. 389, 582 P.2d 980].)

Mutual advances an alternate ground for reversal on the issue of punitive damages, i.e., that the actions of McEachen and Segal cannot be imputed to Mutual for this purpose. In a broad sense, it is correct to state that California follows the Restatement rule regarding assessment

[4]Of course, if there had been a reasonable and carefully investigated foundation for believing that plaintiff's injury did not fall within the scope of the policy coverage, the proposed settlement could not have been considered inappropriate and, accordingly, could not have entered into the jury's decision to award punitive damages.

of punitive damages against a principal: "Punitive damages can properly be awarded against a master or other principal because of an act by an agent if, but only if, (a) the principal authorized the doing and the manner of the act, or (b) the agent was unfit and the principal was reckless in employing him, or (c) the agent was employed in a managerial capacity and was acting in the scope of employment, or (d) the principal or a managerial agent of the principal ratified or approved the act." (Rest.2d Torts (Tent. Draft No. 19, 1973) § 909.) However, prior cases have not ascribed to the Restatement the narrow interpretation proposed by Mutual.[5]

Mutual argues that neither McEachen nor Segal can be considered "managerial employees" because neither was involved in "high-level policy making." The determination whether employees act in a managerial capacity, however, does not necessarily hinge on their "level" in the corporate hierarchy. Rather, the critical inquiry is the degree of discretion the employees possess in making decisions that will ultimately determine corporate policy. When employees dispose of insureds' claims with little if any

[5]*Kuchta* v. *Allied Builders Corp.* (1971) 21 Cal.App.3d 541, 549-550 [98 Cal.Rptr. 588], and *Davis* v. *Local Union No. 11, Internat. etc. of Elec. Workers* (1971) 16 Cal.App.3d 686 [94 Cal. Rptr. 562], support the conclusion that McEachen was a "managerial employee" in a "policy-making position." In *Kuchta*, the actions of a franchisee with managerial authority comparable to that of McEachen were imputed to the principal for the purpose of fixing liability for punitive damages. The court in *Davis* similarly rejected defendant labor union's contention that the actions of its agent, merely an assistant business manager, could not be imputed to the union. These cases focus on the responsibilities of the agent, rather than merely his title, in assessing whether punitive damages are appropriate. To the extent that *Hale* v. *Farmers Ins. Exch.* (1974) 42 Cal.App.3d 681 [117 Cal.Rptr. 146], conflicts with the views expressed herein, we disapprove it.

supervision, they possess sufficient discretion for the law to impute their actions concerning those claims to the corporation.

We are satisfied that with respect to plaintiff's claim herein, the authority vested in McEachen and Segal was sufficient to justify the imposition of punitive damages against Mutual. The record demonstrates they exercised broad discretion in the disposition of plaintiff's claim. Moreover, McEachen's own description of his responsibilities at Mutual reflect his exercise of policy-making authority as a "managerial employee." He testified that his business card displayed to policyholders identified him as "Manager, Benefits Department, Mutual of Omaha." He further explained he was manager of the Los Angeles claims department for Mutual, and in that capacity had ultimate supervisory and decisional authority regarding the disposition of all claims, like that of plaintiff, processed through the Los Angeles office. Although Segal testified that he acted with directions from above, the record provides little support for this testimony; it appears, therefore, that with respect to plaintiff's claim he also possessed broad discretion. The authority exercised by McEachen and Segal necessarily results in the ad hoc formulation of policy.

In concluding that McEachen and Segal were managerial employees, we subscribe to the views of Justice Tamura in his concurring and dissenting opinion in *Merlo* v. *Standard Life & Acc. Ins. Co., supra,* 59 Cal.App.3d at page 25:[6] "It must be remembered that we are here concerned with

[6]The majority in *Merlo* did not decide the question of the managerial status of the defendant insurer's claims representative.

an insurance company dealing in disability insurance, not just any corporation. Manifestly, to plaintiff, [the claims representative's] actions were actions of defendant. [The claims representative] personally managed the most crucial aspects of his employer's relationship with its policyholders. Defendant should not be allowed to insulate itself from liability by giving an employee a nonmanagerial title and relegating to him crucial policy decisions."

III

We turn to the question whether the amount of the punitive damage award herein—$5 million—is excessive as a matter of law. We have recently reviewed the considerations governing appellate determination of such questions, and need not reiterate them at this time. (*Neal* v. *Farmers Ins. Exchange* (1978) *supra,* 21 Cal.3d 910, 927-928, and cases cited.) Applying those considerations to the case at bar, we observe first that the award of punitive damages is more than 40 times larger than the not-insubstantial assessment of $123,600 in compensatory damages against Mutual. In addition, the punitive damage figure herein represents two and one-half months of Mutual's entire net income in 1973, and more than seven months of such income in 1974. Viewing the record as a whole and in the light most favorable to the judgments, we conclude that in these circumstances the punitive damage award against Mutual must be deemed the result of passion and prejudice on the part of the jurors and excessive as a matter of law.

IV

Segal and McEachen acted as Mutual's agents. As such, they are not parties to the insurance contract and not subject to the implied covenant. Because the only ground for imposing liability on either Segal or McEachen is breach of that promise, the judgments against them as individuals cannot stand. (*Gruenberg* v. *Aetna Ins. Co.* (1973) *supra,* 9 Cal.3d at p. 576.)

The judgment against Segal and McEachen is reversed. The judgment against Mutual is affirmed as to the award of compensatory damages[7] and reversed as to the award of punitive damages. Segal and McEachen shall recover their costs on appeal from plaintiff. Plaintiff and Mutual shall bear their own costs on appeal.

Bird, C. J., Tobriner, J., and Manuel, J., concurred.

CLARK, J., Concurring and Dissenting.—I concur in the majority opinion insofar as it holds that included within the implied covenant of good faith and fair dealing is a duty to properly investigate claims and that the evidence

[7]Mutual also contends that the compensatory damage award should be reversed because the trial court permitted the jury to award future policy benefits. It is true that in *Erreca v. Western States Life Ins. Co.* (1942) 19 Cal.2d 388, 402 [121 P.2d 689, 141 A.L.R. 68], this court allowed the recovery of only accrued benefits in an action for breach of a contract for disability insurance. We have never held, however, that future policy benefits may not be recovered in a valid tort cause of action for breach of the implied covenant of good faith and fair dealing, nor does defendant offer any compelling reason for extending *Erreca* to such actions. Thus, in applying to these facts the general rule for fixing tort damages (Civ. Code, § 3333), the jury may include in the compensatory damage award future policy benefits that they reasonably conclude, after examination of the policy's provisions and other evidence, the policy holder would have been entitled to receive had the contract been honored by the insurer.

establishes as a matter of law that the insurer was negligent in investigating. I also concur in reversal of the judgment against Segal and McEachen. However, I dissent on two grounds from the majority's determination that a punitive damage award is permissible in this action.

First, punishing insurance companies for their settlement practices will necessarily result in the industry passing its punishment costs on to the public in the form of increased premiums. By unjustly enriching the claimant, the public ultimately punishes itself. Secondly, even assuming punitive awards are proper against an insurer for its settlement practices, the evidence is insufficient to sustain the instant award. Undisputed evidence shows that when McEachen and Segal were denying further benefits, all medical reports available to them warranted rejecting plaintiff's demands. An insurer should not be deterred from denying claims when the medical information supplied it by an insured's doctors reveals the claims are not compensable. Moreover, the conduct of McEachen and Segal may not be imputed to the insurer for purposes of sustaining an award intended as punishment.

SELF PUNISHMENT

Civil Code section 3294 provides: "In an action for the breach of an obligation *not arising from contract,* where a defendant has been guilty of oppression, fraud, or malice, express or implied, the plaintiff, in addition to the actual damages, may recover damages for the sake of example and by way of punishing the defendant." An action based on an implied covenant must be considered an action arising from contract.

Punitive damages are an anomaly in our civil jurisprudence. The civil law is concerned with vindicating rights and compensating persons for harm suffered as a result of infringement upon those rights. A plaintiff is customarily made whole for infringement by compensatory damages; punitive damages awarded to him rather than to the government constitute a windfall or unjust enrichment for plaintiff. (See, e.g., Carsey, *The Case Against Punitive Damages* (1975) 11 The Forum 57, 60; Note, *Insurance Coverage of Punitive Damages* (1974) 10 Idaho L.Rev. 263, 268.)

The purpose of punitive damage is to punish wrongdoers, deterring further commission of wrongful acts. (*Evans v. Gibson* (1934) 220 Cal. 476, 490 [31 P.2d 389]; Morris, *Punitive Damages in Tort Cases* (1931) 44 Harv.L.Rev. 1173, 1183.) In the usual case, risk of liability for compensatory damage provides a substantial deterrent against wrongful conduct, and additional deterrence furnished by the risk of punitive damage is marginal at best. (Long, *Punitive Damages: An Unsettled Doctrine* (1976) 25 Drake L.Rev. 870, 888; Ghiardi, *The Case Against Punitive Damages* (1972) 8 The Forum 411, 418; Note, *The Imposition of Punishment by Civil Courts: A Reappraisal of Punitive Damages* (1966) 41 N.Y.U.L. Rev. 1158, 1161-1173.)[1]

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[1]Because restitution requires the wrongdoer only to disgorge his ill-gotten gains, compensatory damage will not always constitute a deterrent, and punitive damage may be necessary to deter. (*Ward* v. *Taggert* (1959) 51 Cal.2d 736, 743 [336 P.2d 534].) However, when, as in the instant case, potential compensatory damages are not limited to restitution but extend to consequential damages as well, including mental suffering, the risk of potential compensatory damages constitute a substantial deterrent against wrongdoing.

The principal criticism to the concept of punitive damage is that standards are so vague that the determination whether to award is left to absolute and unguided jury discretion. (*Brewer* v. *Second Baptist Church* (1948) 32 Cal. 2d 791, 801 [197 P.2d 713]; *Ferraro* v. *Pacific Fin. Corp.* (1970) 8 Cal.App.3d 339, 351 [87 Cal.Rptr. 226].) And the damages when awarded are "wholly unpredictable amounts bearing no necessary relation to the actual harm caused." (*Gertz* v. *Robert Welch, Inc.* (1974) 418 U.S. 323, 350 [41 L.Ed.2d 789, 811, 94 S.Ct. 2997]; Ghiardi, *The Case Against Punitive Damages, supra,* 8 The Forum 411, 413-414.)

Others correctly criticize when the cost of punitive awards may be passed on to the public, resulting in a public subsidy of plaintiff windfalls. (Note, *Insurance Coverage of Punitive Damages, supra,* 10 Idaho L.Rev. 263, 268; Carsey, *The Case Against Punitive Damages, supra,* 11 The Forum 57, 60.) Such result, obviously contrary to sound public policy (cf. Gov. Code, § 818 (no punitive damages against a public entity)), is nonetheless risked when punitive damages are awarded against an insurer for deficiencies in its claims practice. (Cf. *Borer v. American Airlines Inc.* (1977) 19 Cal.3d 441, 447 [138 Cal.Rptr. 302, 563 P.2d 858].) The risk becomes a certainty for mutual insurance companies like Mutual. Because future premiums are based largely on past loss experience and administrative expense in the industry, such premiums can be expected to reflect punitive damages paid by the industry. "The public, then, is in the peculiar and indefensible position of penalizing itself with the payment going as unjust enrichment to someone for whom the tort law, through the medium of compensatory damages, already

fully provides." (Long, *Punitive Damages: An Unsettled Doctrine, supra,* 25 Drake L.Rev. 870, 888; Note, *Insurance Coverage of Punitive Damages, supra,* 10 Idaho L.Rev. 263, 268.)[2]

Because each insurer can be expected to attempt to increase its profits and reduce its losses, punitive awards will serve as a substantial deterrent.[3] However, the question raised is whether the deterrent factor is of sufficient importance to justify penalizing the public to support the unjust enrichment of the plaintiff, or whether we should adopt special rules eliminating awards of punitive damages where it is likely the cost will ultimately be borne by the public.[4]

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[2]It has also been pointed out that in mass disaster situations, the award of punitive damages to early litigants may well preclude recovery of even compensatory damages to litigants who subsequently recover judgments. (See, Long, *Punitive Damages: An Unsettled Doctrine, supra,* 25 Drake L.Rev. 870, 877). The same possibility of bankrupting the defendant to the prejudice of bona fide claims for compensatory damages exists whenever the conduct held to warrant punitive award is a widespread or common corporate practice.

[3]While punitive damage award for wrongful claims practice will have a deterrent effect on such practices, I cannot agree with the analysis of footnote 14 of *Neal* v. *Farmers Insurance Exchange* (1978) 21 Cal.3d 910, 929 [148 Cal.Rptr. 389, 582 P.2d 980], that insurers engaging in the wrongful conduct will raise premiums to offset the punitive award whereas other insurers will not, implying that substantial costs will not be passed on to the public. Such analysis ignores the fact that risk of loss for purposes of calculating premiums is ordinarily based on industry-wide losses not the individual company's losses. (Athearn, Risk and Insurance (2d ed. 1964) p. 497; Denenberg et al., Risk and Insurance (1964) p. 383.)

[4]At least four states do not allow punitive damages, recognizing it is the policy of tort law to compensate victims for harm suffered and to limit defendant's obligation to indemnification. (Zuger, *Insurance Coverage of Punitive Damages* (1976) 53 N.D.L.Rev. 239, 249 (La., Mass., Neb., Wash.).) Additionally, three states hold punitive damages are compensatory in nature and limit them accordingly. (*Id.;* N.H., Mich., Conn.)

In determining whether the deterrent factor of punitive damages warrants the public punishing itself to unjustly enrich the claimant, it must be borne in mind that there are alternative deterrents to improper insurer claim practices. An insurer improperly denying benefits and breaching its covenant of good faith and fair dealing is not only liable for all compensatory damages—including damages for mental distress—but can also expect to incur substantial counsel fees and litigation expenses. Considering such deterrent factor, I am of the view that the public should not punish itself for the unjust enrichment of the claimant, and we should not impose punitive damages for improper claims practices.

Although in other situations actions for breach of the obligations imposed by the implied covenant of good faith and fair dealing have been said to sound in both contract and tort, it must be concluded that within the meaning of the punitive damage statute (Civ. Code, § 3294), such an action is one "for the breach of an obligation . . . arising from contract," making the statute inapplicable.

SUFFICIENCY OF EVIDENCE

Our courts have recognized that the law does not favor punitive damages, granting them only in the most outrageous cases. (*Beck* v. *State Farm Mut. Auto Ins. Co.* (1976) 54 Cal.App.3d 347, 355 [126 Cal.Rptr. 602]; *Ferraro* v. *Pacific Fin. Corp.* (1970) 8 Cal.App.3d 339, 351 [87 Cal.Rptr. 226].) In *Gombos* v. *Ashe* (1958) 158 Cal.App.2d 517, 526-527 [322 P.2d 933], Justice Peters enunciated the limited basis for punitive damages award: "Punitive dam-

ages are allowed in certain cases as a punishment of the defendant. They are not a favorite of the law and the granting of them should be done with the greatest caution. They are only allowed in the clearest of cases. In order to warrant the allowance of such damages the act complained of must not only be willful, in the sense of intentional, but it must be accompanied by some aggravating circumstance amounting to malice. Malice implies an act conceived in a spirit of mischief or with criminal indifference towards the obligations owed to others. There must be an intent to vex, annoy or injure. Mere spite or ill will is not sufficient. Mere negligence, even gross negligence, is not sufficient to justify such an award."

Although malice may be proven by circumstantial evidence, the evidence must establish malice in fact rather than malice implied by law. (*Bertero* v. *National General Corp.* (1974) 13 Cal.3d 43, 66 [118 Cal.Rptr. 184, 529 P.2d 608, 65 A.L.R.3d 878].) Mere breach of the covenant of good faith and fair dealing is in itself insufficient to support a finding of intent necessary to justify an award of punitive damages. (*Silberg* v. *California Life Ins. Co.* (1974) 11 Cal.3d 452, at p. 463 [113 Cal.Rptr. 711, 521 P.2d 1103]; *Beck* v. *State Farm Mut. Auto Ins.* (1976) 54 Cal.App.3d 347, 355-356 [126 Cal.Rptr. 602].) Negligent investigation of a claim, while constituting a breach of the covenant of good faith and fair dealing, does not establish malice in fact.

When an insurer has substantial credible evidence that no further benefits are due under the policy, its refusal to pay additional benefits, without more, may not serve as a

basis for awarding punitive damages. If the rule were otherwise, the trier of fact would have discretion to award punitive damages in any case when upon conflicting evidence it found a breach of the insurance contract. Insurers would be unable to litigate questionable claims and would be required to pay dubious claims in all cases to avoid potential liability for punitive damages. The evidence at trial in the present case was sharply conflicting as to whether any benefits were due under the policy in addition to those previously tendered.[5]

The majority base the allowance of punitive damages on the conduct of McEachen and Segal. Viewing the evidence most favorable to plaintiff, their conduct does not warrant an award of punitive damages.

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[5]The defense elicited testimony from plaintiff's doctors that plaintiff's disability was in large part, perhaps 50 percent, due to "discogenic disease," changes that occur over the years rather than traumatic injury. Medical reports also reflected the presence of the disease. The policy limited accidental benefits to injuries "independent of sickness and other causes."

In addition, there was a sharp conflict of evidence as to whether plaintiff was totally disabled within the meaning of the policy. Prior to the 1971 surgery, plaintiff's doctors repeatedly reported that plaintiff would be able to return to work on specified dates. In addition, the policy provided that plaintiff was not entitled to accidental benefits more than a year from injury unless he was unable to engage in any gainful work or service for which he was reasonably fitted by education, training or experience. Plaintiff's orthopedic surgeon estimated that plaintiff would be able to return to work within three to six months of the surgery. In a report in 1972, the surgeon opined that plaintiff should be restricted from repetitive bending but could be on his feet throughout the day, could occasionally lift as much as 50 pounds, and need not be in a sedentary occupation. The surgeon testified at trial that there were occupations plaintiff could perform within limitations.

McEachen

Between 1963 and 1970—prior to his instant injuries—plaintiff claimed and received benefit payments for three separate back-related disabling injuries. Plaintiff was injured in May 1970. He made a fourth claim in June for accidental back injury suffered during the course of his employment. Portions of the claim form were completed by both plaintiff and his physician. The physician estimated plaintiff would be able to return to work in August 1970. In September plaintiff upon returning from a trip to Ireland visited the agency and discussed his claim. This discussion resulted in payment to plaintiff under the policy's accident provisions for a three-month period following date of injury.

Plaintiff filed a supplemental claim in October 1970, stating he was unable to return to work. However, his physician, who signed the claim form on 19 October, stated on the form that plaintiff had been disabled only through 29 September.[6] Because of this contradiction, defendant McEachen, an agency claims manager, investigated the claim. McEachen reviewed workers' compensation and State Compensation Insurance Fund medical records. These records indicated plaintiff and the examining physician had earlier agreed on a 1 July 1970 return to work date.

In short, when on 20 November McEachen visited plaintiff *all* of the available medical evidence stated either that

[6]The physician testified at trial that when he examined plaintiff on 22 September, he stated he was going back to work on 29 September. When the physician examined plaintiff on 9 October, plaintiff stated his former employer did not have any vacant jobs. This information was not available to McEachen on 20 November.

plaintiff's disability should have terminated long before 29 September or that it had terminated by that date. Obviously, McEachen faced with the undisputed medical evidence could not reasonably be expected to pay benefits beyond 29 September. Although, as the majority point out, plaintiff may have stated he needed money for the approaching Christmas season, an insurer is not Santa Claus. Plaintiff also offered to be examined by any doctor named by the insurer but since plaintiff's doctor had stated he was not disabled, the onus was not on the insurer to obtain a second opinion.

Insofar as the majority opinion indicates that McEachen should have paid disability benefits for periods after 29 September, it is unreasonable. Insofar as the opinion suggests that McEachen's refusal to pay such benefits furnishes a basis for punitive damages, it is absurd.

It is true that McEachen in denying benefits used intemperate language in stating that plaintiff was a fraud, but in view of the uncontracted medical reports stating plaintiff was no longer disabled, such language does not warrant an award of punitive damages.[7]

Segal

Following his surgery on 26 February 1971, plaintiff submitted a new proof-of-loss form on 5 April 1971. This claim was assigned to defendant Segal, an agency claims adjuster. Segal was aided in his field investigations by claims

[7]There were additional circumstances questioning plaintiff's good faith. During his trip abroad, plaintiff was collecting not only on the instant policy but also on a second one from the insurer, and he was entitled to workers' compensation benefits while disabled. (He received a 73 percent disability rating on the compensation claim.)

analyst Romano from Mutual's home office. Although not entirely clear, it appears Romano was assigned to the agency to assist in a backlog of field investigations. Romano was not Segal's superior; rather, he occupied a position equivalent to Segal's position with the agency.

Segal and Romano, in the course of their field investigations, reviewed records of Workers' Compensation Appeals Board, State Compensation Insurance Fund, and the hospital where plaintiff's surgery was performed. State Compensation Insurance Fund records contained letters from Dr. Carpenter, plaintiff's surgeon, and Dr. Singelyn. Dr. Carpenter stated in his letter: "[plaintiff's medical] history appears consistent with a man with probable discogenic disease with multiple aggravations over the last several years, finally culminating in a specific incident a little over seven months ago . . . ." Dr. Singelyn stated in his letter: "I would apportion 50% of his current subjective complaints to his industrial injury, and 50% to the natural progression of his preexisting pathology of degenerative wear and tear osteoarthritis of the spine." Neither Segal nor Romano made an effort to reach plaintiff's physicians. Based on Segal's review of medical records, plaintiff's condition was reclassified from one of injury to one of nonconfining illness.

In May 1971 Segal visited plaintiff at home, telling him he suffered from an illness—not an injury. Segal handed plaintiff a check for medical costs and three months' disability payments, the maximum benefits for disability due to nonconfining illness. Plaintiff did not cash the check. He testified he refused Segal's offer of a larger check if plaintiff would surrender his policy.

In addition to the tendered benefits for illness, the policy provided for lifetime benefits if the insured became totally disabled as a result of an accidental injury "independent of sickness and other causes."

The only reasonable construction of the information reviewed by Segal was that plaintiff's disability was due to sickness or other causes in addition to the accident. Plaintiff's surgeon reported discogenic disease, and the other doctor reported preexisting pathology. Again, insofar as the majority opinion may indicate that Segal should have paid accident benefits on the basis of the information available to him, it is unreasonable. Insofar as the opinion suggests that Segal's refusal to pay such benefits warrants an award of punitive damages, it is absurd.

What practices are the majority attempting to deter by allowing punitive damages? Is it an improper insurance practice warranting punitive damages to deny claims when the medical reports of the plaintiff's treating physicians show that no benefits are due?

The only significant wrongful conduct on the part of the adjusters was that they did not make efforts to discuss the case with the physicians, instead relying upon the physicians' written reports.[8] Testimony at trial established that efforts to discuss the case with the attending physician

[8]Insofar as McEachen was concerned, a discussion with the attending physician would not have been helpful to plaintiff. Such discussion only could have confirmed the conclusion that petitioner's total disability terminated by 29 September. (See fn. 5.)

would ordinarily have been made by a claims adjuster.[9] However, the failure to make efforts to consult the physicians shows only a careless mistake. The adjusters, at most, acted on the basis of a careless mistake. (See *Wolfsen* v. *Hathaway* (1948) 32 Cal.2d 632, 649 [198 P.2d 1].) The fact the information resulted from poor investigation does not elevate their mental states to malice. An act performed on the basis of erroneous information, when the error is unknown, does not constitute oppression or fraud and cannot be equated with conduct "conceived in a spirit of mischief or with criminal indifference . . . . Mere negligence, even gross negligence, is not sufficient to justify" an award of punitive damages. (*Gombos* v. *Ashe, supra*, 158 Cal.App.2d 517, 526-527.)[10]

Moreover, even assuming the adjusters' conduct could be found to be malicious, such conduct may not be imputed to Mutual for purposes of sustaining a punitive award.

Although the doctrine of respondeat superior generally imposes liability on an employer for the torts of its employees, the doctrine will not support an award of punitive damages against a principal. (*Ebaugh* v. *Rabkin* (1972) 22 Cal.App.3d 891, 895 [99 Cal.Rptr. 706].) Punitive dam-

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[9]The majority also suggests that Segal's offer to settle was improper, warranting punitive damages. However, the majority concede that the offer was proper had Segal made a proper investigation. (*Ante*, p. 822, fn. 4.) Accordingly the basis of impropriety is the improper investigation.

[10]There is also evidence of wrongdoing by the insurer in that plaintiff's file was lost in the home office and that the ordinary procedures of review of adjuster's decision to terminate benefits were not followed. The majority do not rely on the breakdown in the insurer's ordinary procedures for review. In any event, the insurer's negligent failure to follow its own procedures may not warrant punitive damages.

ages may properly be awarded against a principal for the acts of its agent only if: (a) the agent was employed in a managerial capacity and acted within the scope of his employment; (b) the principal ratified or approved the act; (c) the principal authorized the performance and manner of performing the act; or (d) the agent was unfit and the principal was reckless in employing him. (*Deevy* v. *Tassi* (1942) 21 Cal.2d 109, 125 [130 P.2d 389]; *Hale* v. *Farmers Ins. Co.* (1974) 42 Cal.App.3d 681, 691 [117 Cal.Rptr. 146]; Rest.2d Torts (Tent. Draft No. 19, 1973) § 909.)

A managerial employee for purposes of imposing punitive damage must occupy a high level *policy-making*—as opposed to a *policy-implementing*—position. (E.g., *Lowe* v. *Yolo County etc. Water Co.* (1910) 157 Cal. 503, 510-511 [108 P.2d 297] [corporate president]; *Davis* v. *Local Union No. 11, Internat. etc. of Elec. Workers* (1971) 16 Cal.App. 3d 686, 698 [94 Cal.Rptr. 562] ["No. 2 man"]; *Toole* v. *Richardson-Merrell, Inc.* (1967) 251 Cal.App.2d 689, 712 [60 Cal.Rptr. 398, 29 A.L.R.3d 988] [high level management].) When those who control the corporation, and who are in essence the corporation itself, seek to further its interest through adoption of malicious, oppressive, or fraudulent policies, imposition of punitive damages may achieve its deterrent purpose because such award is directed at the corporation itself. However, to impose punitive damages because one of the corporate employees improperly applied an otherwise lawful and reasonable corporate policy, simply serves to enlarge judgments. In such case, the corporation itself may not properly be con-

sidered the actual wrongdoer. It has formulated policies and directed its employees in a manner consistent with the law. The deterrence, if any, is ineffective.

In *Hale* v. *Farmers Ins. Exch., supra,* 42 Cal.App.3d 681, 697, a claims supervisor—a position analogous to McEachen's—with authority to deny claims, was held not a managerial employee for purposes of punitive damages. The fact McEachen possessed authority to accept or reject claims does not warrant finding him a managerial employee. As noted, the claims supervisor in *Hale* possessed such authority. Further, acceptance of such a rule would equate punitive damage liability with respondeat superior liability. Under such an approach virtually any employee having the capacity to effect a decision would be a managerial employee for purposes of assessing punitive damages. This would extend the concept to a vast majority of corporate employees.

The rule that punitive damages may be awarded against a corporation only for the conduct of its managerial employees does not permit a corporation to absolve itself of all responsibility merely by formulating a proper policy without supervising its execution. The corporation remains liable for all compensatory damages resulting from an incorrect decision by its employees. In addition corporate policy forming a basis for imposition of punitive damages does not require a showing of a formal adoption of the policy by resolution or formal direction by a managing official, but may be established as a de facto policy upon a showing of uniform course of conduct by lower level employees. A single act by one employee in an isolated instance does not, of course, establish a de facto policy. Thirdly, the corporation may incur liability for punitive damages if it ratifies employee conduct.

The award of punitive damages may not be predicated on authorization or ratification of the adjusters' conduct by Mutual. There is no evidence Mutual specifically authorized their conduct. Ratification may not be established by the fact Mutual continued to employ the adjusters. Retention alone cannot support an award of punitive damages. (*Coats* v. *Construction & Gen. Laborers, Local No. 185* (1971) 15 Cal.App.3d 908, 915 [93 Cal.Rptr. 639].) A rule allowing mere retention to support a finding of ratification would be unduly harsh on employees as appears in this case. To allow retention without more to establish ratification would place a tremendous incentive on employers to terminate employees whenever any question concerning their conduct might be raised. (See *Sullivan* v. *Matt* (1955) 130 Cal.App.2d 134, 144 [278 P.2d 499].)

The record is simply not sufficient to sustain an award of punitive damages.

RICHARDSON, J., Concurring and Dissenting.—I concur in the judgment. For the reasons well expressed in Justice Clark's concurring and dissenting opinion, however, I disagree with the majority's conclusion that punitive damages are recoverable under the circumstances presented in this case. As Justice Clark explains, the careless, negligent conduct of claims agents McEachen and Segal would not constitute that form of "oppression, fraud, or malice" required by section 3294 of the Civil Code for imposition of exem-

plary damages. Moreover, it is doubtful that the conduct of these persons should be imputed to their employer, under the evidence adduced in this case.

Unlike Justice Clark, however, I would not absolutely preclude an award of punitive damages in every case involving a breach by an insurer of the implied covenant of good faith and fair dealing. We have previously held that such a breach sounds in both contract *and tort* (*e.g., Gruenberg* v. *Aetna Ins. Co.* (1973) 9 Cal.3d 566, 573-575 [108 Cal.Rptr. 480, 510 P.2d 1032]), and that punitive damages are recoverable for an aggravated breach of the implied covenant, so long as the insurer has acted " 'with the intent to vex, injure, or annoy, or with a conscious disregard of the plaintiff's rights.' " (*Neal* v. *Farmers Insurance Exchange* (1978) 21 Cal.3d 910, 922 [148 Cal.Rptr. 389, 582 P.2d 980], quoting from *Silberg* v. *California Life Ins. Co.* (1974) 11 Cal.3d 452, 462 [113 Cal.Rptr. 711, 521 P.2d 1103].) My dissent from the majority opinion in *Neal* was directed at entirely different issues from that relating to the above principle.

The *Neal* majority, for example, deemed an award of punitive damages justified by evidence that the insurer was pursuing a conscious policy to utilize the insured's exigent financial circumstances as a lever to force a settlement more favorable to the insurer than the facts otherwise would have warranted. (*Id.*, at p. 923.)

Thus, I would not eliminate the possibility of a punitive damages award in an appropriate case, where the acts of the insurer demonstrate actual malice, fraud or oppression. As Justice Clark observes, it is true that the insurer may simply pass on the punitive award to its customers in the form of increased premiums. Yet as the *Neal* majority explained, increased premiums thereby charged may permit the insurer's competitors to obtain a competitive advantage, thus promoting, to a degree at least, the object of deterrence which underlies an award of punitive damages, and "resulting in an ultimate benefit to insurance consumers as a whole." (*Id.*, at p. 929, fn. 14.)

In the Supreme Court
of the
State of California

L.A. No. 30747, Oct. 11, 1979

Michael Egan,
Plaintiff and Respondent,
vs.
Mutual of Omaha Insurance Company
et al.,
Defendants and Appellants.

[Modification* of opinion (24 Cal.3d 809; — Cal.Rptr. —, — P.2d —).]

THE COURT.—The opinion herein, appearing at 24 Cal.3d 809, is modified by adding the following sentence at the end of footnote 7, page 824:

To the extent it is inconsistent herewith, *Austero* v. *National Cas. Co.* (1978) 84 Cal.App.3d 1, 24-25 [148 Cal.Rptr. 653], is disapproved.

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*This modification requires adding the following sentence at the end of headnote (11), page 814 of the bound volume report: "(Disapproving *Austero v. National Cas. Co.* (1978) 84 Cal.App. 3d 1, 24-25 [148 Cal.Rptr. 653], to the extent it is inconsistent with the opinion.)"

Appendix B

Superior Court of the State of California
for the County of Los Angeles

Case No. EA C 15054

Michael Egan,
Plaintiff,
vs.
Mutual of Omaha Insurance Company
et al.,
Defendants.

RULING ON MOTION FOR NEW TRIAL

The failure to take reasonable steps to ascertain Mr. Egan's actual medical status by exercising the right under the policy for a medical examination by a doctor of their own choice and the failure to exercise minimal safeguards by consulting with either or both the treating doctor or the operating surgeon was one factor which the Court did and jury could have considered as showing complete disregard for the rights of the insured who it was also known had a totally disabled wife and a 12-year-old child. Practically every defense witness testified that said action was taken on insufficient information and without proper investigation.

The totality of the evidence is clearly sufficient to sustain the Court's ruling as a matter of law that the defendant, Mutual of Omaha, and each individual defendant violated

their duty of good faith and fair dealing with regard to the reclassification of Mr. Egan's insurance policy.

The evidence further demonstrates that Mutual of Omaha authorized and ratified the actions of defendants Segal and McEachen. The relationship of Mutual of Omaha to the Hall-Worthing Agency and to the individual defendants and the context of this particular transaction amply sustain this finding.

COMPENSATORY DAMAGES: The Court finds that the amounts awarded by the jury were just and fair as to each defendant in light of the evidence presented and in accord with the actions of each defendant. The Court was aware of the problem concerning present damages award for future disability payments to Mr. Egan under the insurance contract. However, there was no evidence offered by defendants to negate the overwhelming evidence of Mr. Egan's total permanent disability. Counsel for defendants stated to the jury that if Mr. Egan remained totally disabled, he would be entitled to the $45,600. There being uncontroverted evidence of permanent disability, the award is just and proper.

PUNITIVE DAMAGES: The Court finds that the awards are appropriate to the actions of each of the defendants and the amounts of such awards are proper having in mind the actions of defendants, their assets, and the purpose of such damages. The conscience of the Court is not shocked by the awards and the Court does not believe said awards to be the result of bias, prejudice, hostility, or "runaway verdicts."

The verdict forms presented to the jury were drawn after discussion, agreement of all counsel and stipulated to on the record.

The judgment of the jury and the amounts awarded as to the respective defendants would be illuminated by the reading of the transcript. Even such a reading would not clearly illustrate the following matters which were obvious to the jury and to the Court:

The first matter is that this case was tried before a jury which the Court deemed to be qualified, attentive, and conscientious, and in a judicial atmosphere free from hostility and animosity; and argument of counsel, not present at the trial, to the contrary, is not in any respect justified.

The Court at the beginning of the case refused plaintiff's offer to show by evidence other cases of improper insurance policy reclassification and that such a policy was followed by Mutual of Omaha. Even though Mr. Shernoff protested that such evidence was necessary to his case, the Court ruled that for purposes of conservation of Court time and because of prejudice to the defendant, Mutual of Omaha, such evidence was to be rejected. The Court informed Mr. Shernoff he was to try this alleged violation of his client's rights on its merits with no reference to other matters. Mr. Shernoff deferred to the Court's ruling. This is stated to show that the trial was held in what the Court believed to be an atmosphere of neutrality and fairness to all parties.

The second matter concerns the credibility of witnesses. The Court, and I believe the jury, had an opportunity to

apply the standards for judging credibility as set forth in the Court's instructions.

It appears to the Court, and I believe to the jury, that there was little credibility in the witnesses offered by the defense.

The fact of credibility loss is borne out somewhat by the transcript, but could only be fully apparent to those present to witness for themselves the appearances on the stand and to hear the testimony of the witnesses offered by Mutual of Omaha.

The third matter that the Court, and I believe the jury, considered in reaching their verdict was the conflict in the position of the respective defendants.

Before the trial began, the Court discussed with counsel the problem of representing the defendants when their respective positions were in conflict. The Court was assured that no such conflict was in the case. At the end of plaintiff's case, Mr. Shernoff, outside the presence of the jury, pointed out the conflict which was then apparent. Upon questions by the Court, counsel for the defendants assured the Court that all defendants were in agreement regarding being represented by the same counsel. *Counsel refused to answer a question directed by Mr. Shernoff asking whether Mutual of Omaha had committed themselves to pay off any judgment against Mr. Segal.* This question was justified because it was apparent that Mr. Segal and Mutual of Omaha and Mr. McEachen were in positions of conflict.

It is the belief of the Court, and I am sure of the jury, that this conflict, discussed outside the presence of the jury, was apparent and justified the conclusion that Mutual of Omaha and its witnesses were shifting the responsibility to Mr. Segal and that this was being done because plaintiff would recover a minimal judgment as to Mr. Segal.

This appeared to be an attempt to use the trial, the jury, and the Court to mask the breach of duty of Mutual of Omaha to the insured; and, I believe, was a further reason why the jury believed that the duty to use good faith and fair dealing as to Mr. Egan had been and was being violated.

The lack of credibility of Mutual of Omaha's witnesses and of the individual defendants was apparent. The representation of defendants in positions of conflict and the attempt to place all responsibility on that defendant least able to pay any reasonable judgment, if a violation was found, seemed apparent and obvious.

For the above reasons, the motions for new trial and judgment notwithstanding the verdict are denied.

Dated January 22, 1975

/s/ HOWARD D. McCLAIN
Howard D. McClain
Los Angeles County
Superior Court

Appendix C

Superior Court of California,
County of Los Angeles

[Filed Nov. 26, 1974]

Case Number EA C 15054

Michael Egan,
Plaintiff,

vs.

Mutual of Omaha Insurance Company,
a corporation, et al.,
Defendant.

JUDGMENT ON VERDICT IN OPEN COURT
(LONG FORM)

This action came on regularly for trial on November 6, 1974; in Department East M of the above entitled Court, the Honorable Howard D. McClain Judge presiding; the plaintiff(s) appearing by attorney William Shernoff for Hafif and Shernoff and the defendant(s) appearing by attorneys Don Wild and A. B. Doutre for Poindexter and Doutre.

A jury of 12 persons was regularly impaneled and sworn to try the action. Witnesses on the part of the plaintiff(s) and the defendant(s) were sworn and examined. After hearing the evidence, the arguments of counsel, and instructions of the Court, the jury retired to consider of their verdict, and subsequently returned into Court, and being

called answered to their names and duly rendered their verdict in writing in words and figures as follows, to-wit:

"TITLE OF COURT AND CAUSE" We, the jury in the above entitled action, find for the Plaintiff Michael Egan and against the Defendant T. McEachen and assess Compensatory damages for mental and emotional distress in the sum of $1,000.00: Punitive damages in the sum of $500.00.

Dated November 25th, 1974

Stan E. Creveston Foreman

"TITLE OF COURT AND CAUSE" We, the jury in the above entitled action, find for the Plaintiff Michael Egan and against the Defendant Jon M. Segal and assess Compensatory damages for mental and emotional distress in the sum of $500.00: Punitive damages in the sum of $400.00.

Dated November 25th, 1974

Stan E. Creveston Foreman

"TITLE OF COURT AND CAUSE" We, the jury in the above entitled action, find for the Plaintiff Michael Egan and against the Defendant Mutual of Omaha Insurance Company, a corporation and assess Compensatory damages for Policy benefits in the sum of $45,000.00: Compensatory damages for mental and emotional distress in the sum of $78,000.00: Punitive damages in the sum of $5,000,000.00.

Dated November 25th, 1974

Stan E. Creveston Foreman

WHEREFORE, by virtue of the law, and by reason of the premises aforesaid, it is ordered, adjudged, and decreed that said Plaintiff Michael Egan have and recover from said Defendant T. McEachen the sum of $1,500.00 with interest thereon at the rate of seven per cent per annum from the date of the verdict until paid together with costs and disbursements amounting to the sum of $.....

WHEREFORE, by virtue of the law, and by reason of the premises aforesaid, it is ordered, adjudged and decreed that said Plaintiff Michael Egan have and recover from said Defendant Jon M. Segal the sum of $900.00 with interest thereon at the rate of seven per cent per annum from the date of the verdict until paid together with costs and disbursements amounting to the sum of $.....

WHEREFORE, by virtue of the law, and by reason of the premises aforesaid, it is ordered, adjudged, and decreed that said Plaintiff Michael Egan have and recover from said Defendant Mutual of Omaha Insurance Company, a corporation the sum of $5,123,600.00 with interest thereon at the rate of seven per cent per annum from the date of the verdict until paid together with costs and disbursements amounting to the sum of $.....

Appendix D

In the
Supreme Court of the State of California

L.A. No. 30747

Michael Egan,
Plaintiff and Respondent,
vs.
Mutual of Omaha Insurance Company et al.,
Defendants and Appellants.

Appeal County Los Angeles
Superior Court No. EAC 15054

The above-entitled cause having been heretofore fully argued and submitted,

It Is Ordered, Adjudged, and Decreed by the Court that the judgment of the Superior Court of the County of Los Angeles in the above-entitled cause, against Segal and McEachen is reversed. The judgment against Mutual is affirmed as to the award of compensatory damages and reversed as to the award of punitive damages. Segal and McEachen shall recover their costs on appeal from plaintiff. Plaintiff and Mutual shall bear their own costs on appeal.

I, ..., Clerk of the Supreme Court of the State of California, do hereby certify that the foregoing is a true copy of an original judgment entered in the above-entitled cause on the 14th day of August, 1979.

Witness my hand and the seal of the Court, this 11th day of October, 1979.

.....
Clerk

By .....
Deputy

Appendix E

Clerk's Office, Supreme Court
4250 State Building

San Francisco, California 94102
October 11, 1979

I have this day filed Order

REHEARING DENIED

In re: L.A. No. 30747

Egan

vs.

Mutual of Omaha Ins. Co.

Respectfully,
G. E. Bishel
Clerk

Appendix F

Pettit & Martin
Joseph W. Rogers, Jr., Esq.
600 Montgomery Street, 21st Floor
San Francisco, California 94111
(415) 434-4000

Attorneys for Appellant
Mutual of Omaha Insurance Company

[Filed Nov. 13, 1979]

Superior Court of the State of California
for the County of Los Angeles

Mutual of Omaha Insurance Company, a corporation, Appellant, vs. Michael Egan, Appellee.	EAC 15054

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Mutual of Omaha Insurance Company, the appellant above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of California, remanding for retrial appellee Michael Egan's cause of action for punitive damages; decision filed on August 14, 1979, with all petitions for rehearing denied October 11, 1979.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

This Notice of Appeal is filed herein on the assumption that the clerk of this court is now "possessed of the record" within the meaning of Rule 10(3) of the Supreme Court of the United States. A copy of a concurrent Notice of Appeal, being filed in the Supreme Court of California is attached as Exhibit A hereto for information.

Dated: November 1, 1979.

PETTIT & MARTIN

By Joseph W. Rogers, Jr., Esq.
Attorneys for Appellant

Pettit & Martin
Joseph W. Rogers, Jr., Esq.
600 Montgomery Street, 21st Floor
San Francisco, California 94111
(415) 434-4000

Attorneys for Appellant
Mutual of Omaha Insurance Company

In the Supreme Court
of the State of California

Mutual of Omaha Insurance Company, a corporation, **Appellant,** **vs.** **Michael Egan,** **Appellee.**	**LA 30747**

NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES

Notice is hereby given that Mutual of Omaha Insurance Company, the appellant above-named, hereby appeals to the Supreme Court of the United States from the final judgment of the Supreme Court of the State of California, remanding for retrial appellee Michael Egan's cause of action for punitive damages; decision filed on August 14, 1979, with all petitions for rehearing denied October 11, 1979.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Exhibit A

This Notice of Appeal is filed herein on the assumption that the clerk of this court is still "possessed of the record" within the meaning of Rule 10(3) of the Supreme Court of the United States. A copy of a concurrent Notice of Appeal, being filed in the Los Angeles Superior Court is attached as Exhibit A hereto for information.

Dated: November 1, 1979.

PETTIT & MARTIN

By Joseph W. Rogers, Jr., Esq.
Attorneys for Appellant

Certificate of Service

I, Joseph W. Rogers, Jr., counsel for appellant herein, hereby certify that on November 2, 1979, I served the attached NOTICE OF APPEAL TO THE SUPREME COURT OF THE UNITED STATES on all parties to the proceeding below, by placing a true copy thereof in a sealed envelope with first-class postage thereon fully prepaid, in the United States mail at San Francisco, California, addressed to counsel of record as follows:

Herbert Hafif
269 West Bonita Avenue
Claremont, California 91711

William Shernoff
666 South Indian Hill
Claremont, California 91711
Attorneys for Appellee, Michael Egan

Robert A. Seligson
300 Montgomery Street, Suite 821
San Francisco, California 94104
Attorney for Defendants Jon Segal and Andrew T. McEachen

I further certify that copies have also been mailed in duly addressed envelopes, with first-class postage prepaid, to:

Poindexter & Doutre
624 South Grand Avenue
Los Angeles, California 90017

Kaplan, Livingston, Goodwin, Berkowitz & Selvin
450 North Roxbury Drive
Beverly Hills, California 90210

O'Brien & Hallisey
One California Street
San Francisco, California 94111

Adams, Duque & Hazeltine
523 West 6th Street
Los Angeles, Caiifornia 90014

Ropers, Majeski, Kohn, Bentley & Wagner
1125 Marshall Street
Redwood City, California 94063

Beardsely, Hufstedler & Kemble
611 West 6th Street
Los Angeles, California 90017

Robert E. Cartwright
Robert G. Beloud
LeRoy Hersh
David B. Baum
Stephen I. Zetterberg
Ned Good
Arne Werchick
Sanford M. Gage
Roger H. Hedrick
Leonard Sacks
c/o Robert E. Cartwright
160 Sansome Street
San Francisco, California 94104

Court of Appeal
Second Appellate District
217 West First Street
Los Angeles, California 90012

Clerk, Superior Court
Los Angeles County
105 E. County Courthouse
Los Angeles, California 90012

I further certify that all parties required to be served have been served.

DATED: November 2, 1979

JOSEPH W. ROGERS, JR., ESQ.
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